

Before the
Federal Communications Commission
Washington, D.C. 20554

In the matter of)
)
Federal-State Joint Board on)
Universal Service) CC Docket No. 96-45
)
)
)

Comments on Notice of Proposed Rulemaking by
Maine Public Service Commission,
Montana Public Service Commission, and
Vermont Public Service Board

Contents

1.	Introduction.....	2
2.	The Commission should define “urban” in a way that satisfies common usage. The best choices would be based on density, although the Commission could use wire center size.	2
3.	The Commission should continue to calculate support based upon costs or other objective data but should also measure rates and use that data to verify the success of its program.	5
4.	The Commission should define rural rates to be “reasonably comparable” when they are not more than 125 percent of average urban rates.	7
5.	The Commission should not establish a goal of reducing fund size.....	12
6.	If rates are reasonably comparable then support is sufficient.....	14
7.	In determining whether federal support is sufficient, the Commission should assume that states will ensure comparable rates within their own borders and should continue to use statewide average costs.....	14
8.	The Commission should explain the relationship of any benchmark it selects to urban cost.	18
9.	The Commission should adopt a new benchmark not higher than 125% of urban cost. ...	18
10.	The Commission Should Not Adopt A Step Function Benchmark	20
11.	If the Commission establishes a condition of federal support, it should require no more than that states certify compliance with the comparability requirements of section 254.21	

1. INTRODUCTION

On February 15, 2002, the commission released a Notice of Proposed Rulemaking (“Notice”) seeking comment on the issues from the *Ninth Report and Order* remanded by the United States Court of Appeals for the Tenth Circuit. The Maine Public Service Commission, the Montana Public Service Commission and the Vermont Public Service Board (“Rural State Commissions”) hereby respectfully submit initial comments on the questions raised in that notice.

2. THE COMMISSION SHOULD DEFINE “URBAN” IN A WAY THAT SATISFIES COMMON USAGE.

THE BEST CHOICES WOULD BE BASED ON DENSITY, ALTHOUGH THE COMMISSION COULD USE WIRE CENTER SIZE.

In order to comply with the Act, the Commission must provide sufficient support so that each state can achieve rates comparable with those in the urban areas of the nation. To do this the Commission must determine: 1) a working definition of “urban”¹; 2) the average urban cost; and 3) a definition of “reasonable comparability.” The Commission first seeks comment on how to define “urban.” The Rural State Commissions suggest that a density-based approach would be best, closely followed by a wire center size approach.

In enacting Section 254, the Congress had in mind that the short loops and high densities in urban areas can produce significantly lower costs and rates. To align its support system to Congressional intent, the Commission should seek a definition of “urban” that applies solely to areas generally recognized as meeting that category. Three plausible options are available.

¹ It is probably not necessary for the Commission to define “rural.” High-cost (high-rate) rural customers are likely to be complaining parties in any challenge to the sufficiency of Commission support. Thus “rural” will to some extent be self-defining. Any challenge will very likely test the relationship between the rates or net costs of a particular rural plaintiff against those of urban customers.

The most suitable choice is to define “urban” based upon population density or line density. One sub-option is to rely primarily on United States Census definitions. For the 2000 Census, the Census Bureau has classified "urban" as all territory, population, and housing units located within an urbanized area (“UA”) or an urban cluster (“UC”). It delineates UA and UC boundaries to encompass densely settled territory, which consists of census block groups or blocks that have a population density of at least 1,000 people per square mile and surrounding census blocks that have an overall density of at least 500 people per square mile.² The Census further defines “rural” as all territory, population, and housing units located outside of UAs and UCs. Geographic entities, such as census tracts, counties, metropolitan areas, and the area outside metropolitan areas, often contain both urban and rural territory, population, and housing units.

If the Commission adopts a Census definition and also decides to continue to base nonrural support on Synthesis Model costs, it would then need a way to determine which wire centers are “urban.” To do this, it might classify a wire center as an “urban wire center” if at least 75% of the area served by the wire center is an urbanized area. Likewise, a wire center would be a “rural wire center” if at least 75% of the area served by the wire center is *not* in an urbanized area. This task can be accomplished in a fairly straightforward manner with GIS software. The result would be three defined sets of wire centers: those that are predominantly urban (meaning 75% urban or greater); those that are predominantly rural; and those that have mixed characteristics. The “reasonable comparability” test then could be based upon a rural customer’s relationship to the average cost of the urban group.

² In addition, under certain conditions, less densely settled territory may be part of each UA or UC.

This Census approach for defining “urban” has some attractions. The Census definition is complex, but that adds flexibility on matters of great localized interest, such as how to treat related but non-contiguous metropolitan areas. It reduces the probability that the Commission’s decisions about what areas are “urban” will be criticized for ignoring local conditions.

In no event should the Commission rely on Metropolitan Statistical Areas (“MSA”) to define either either “urban” or “rural.” Many vast rural areas are included in Metropolitan Statistical Areas. For example, the presence of a city in a very large county has resulted in large portions of Arizona and Nevada being included within MSAs, even though the areas included are largely empty desert or very sparsely populated.³

A second density-based approach would be to rely upon the “density zone” features of the Synthesis Cost Model.⁴ The Synthesis Cost Model apparently has the capability of making classifications by line density.⁵ The Commission might define the last one or two such zones as “urban.” This choice would require the Commission to perform a nationwide run of the Synthesis Cost Model, set to produce density zone outputs. Both such tasks are beyond the current capacity of the Rural State Commissions, and we are unable to comment in detail the average urban cost that this alternative would produce.

A third approach is more direct but possibly less desirable. That is to rely on wire center size, as reported by the Synthesis Cost Model outputs.⁶ Data for this method are readily

³ Similar problems are apparent in the east. For example, it appears that the entire state of New Jersey is in one or another MSA, even though there are in fact many rural areas in New Jersey. Likewise, St.Louis County Minnesota is an MSA, because of the presence of Duluth in that county, and even though a large portion of that county is very thinly populated.

⁴ This choice would be appropriate only if the Commission continues to rely upon this model.

⁵ The workfiles produced by the Synthesis Cost model classify wire centers into nine density zones: 0; 5; 100; 200; 650; 850; 2,550; 5,000 and 10,000 lines per square mile.

⁶ Once again, this choice is appropriate only if the Commission continues to rely upon this model.

available,⁷ and it is a simple matter to exclude smaller wire centers from the average cost calculation. This is a plausible procedure because urban densities and practical limits to loop lengths ensure that nearly all such large wire centers are in fact located in urban areas.⁸ On the whole, these large wire centers should be reliably urban and should offer a plausible, if less than ideal, method of estimating urban cost.⁹

3. THE COMMISSION SHOULD CONTINUE TO CALCULATE SUPPORT BASED UPON COSTS OR OTHER OBJECTIVE DATA BUT SHOULD ALSO MEASURE RATES AND USE THAT DATA TO VERIFY THE SUCCESS OF ITS PROGRAM.

The Commission sought comment on what it should measure when determining whether rates are comparable. Notice para.16. The Rural State Commissions urge the Commission to base support on measurements of cost or other objective data, but also to collect rate data and use that data to evaluate the success of its support programs.

It is very difficult to validly and reliably measure telephone rates.¹⁰ A fundamental problem is that the level of basic exchange rates is as much a function of state policy as it is of underlying costs. For example state commissions often balance exchange rates and toll rates when they allocate joint loop costs. Therefore a state that allocates most loop costs to toll and access services generally can have high costs and also have low exchange rates. Another

⁷ USAC makes available in spreadsheet form the cost data output of the Synthesis Model, organized by wire center. These data are subject to a protective order and may be disclosed to a person or organization only if the person or organization completes a disclosure form for USAC and asserts that the data will be used for purposes specified by the FCC.

⁸ Some wire centers with a large number of lines may serve some rural customers. Wire center size thus could in individual cases be an accident of history.

⁹ This is the approach taken below in our comments below, primarily because it is the only method within our capacity to calculate.

¹⁰ The General Accounting Office recently issued a report attempting to do this, but even its considerable effort left some observers thinking that important aspects of the measurement had been overlooked.

difficulty is the scope of service. Some states include some “vertical” services¹¹ on a non-optional basis in local exchange bills and offer large local calling scopes. All else equal, these states are likely to have higher local rates. Finally state regulatory policy with regard to such things as depreciation and return are likely to influence the local rate level.¹²

The Commission should therefore not base support solely upon rates. Even if it were possible to overcome the preceding difficulties and define a reliable measure of rates, to base support on such a calculation might introduce distorting incentives into the state ratemaking process.

The Commission has historically relied upon either accounting (“embedded”) costs or forward-looking costs for this purpose. This has significant advantages, although it is also a complex task, particularly the latter form. It may also be possible to calculate support in a way that is less complex and that requires less data collection from carriers. For the immediate purposes of the remand, however, the Rural State Commissions accept the need to continue to calculate support based upon costs, however measured.

Still, rates are the statutory touchstone in section 254, and they should not be slighted. Rate data, even if flawed, is important and can be useful. The data collection methodology can be refined over time, but even currently available rate data can serve some important purposes. Congress is likely to be interested in how rates are actually affected by federal universal service support, and the courts may share this curiosity. It was probably not an accident that the recent GAO report focused upon rates, not costs. Congressmen and regulators may have different views on the deficiencies of rates as a measure of program success.

¹¹ So-called “vertical services” include call-waiting and caller identification functions.

¹² If rate level rather than cost were used to determine universal service funding, it would be desirable to consider defining a uniform basket of services including local exchange, some local calling areas, some toll usage, and

Second, the rate level for a basket of service can offer an important check on whether the comparability requirements of § 254 are being met. For example, if a state receiving a great deal of federal funding has very low rates (below the urban average), then the model or some other component of the support system may not be working. A modification of the support mechanism or the cost models may be needed. Conversely, if a state receives no support yet has high average rates, that is direct evidence that added federal support is needed to produce reasonably comparable rates.

The Synthesis Cost Model is a complex tool. It depends upon hundreds of global assumptions about cost drivers, and it literally uses hundreds of thousands of location-specific facts, any of which could contain errors. Modelers often seek to align their products with reality. Weather forecasters, for example, frequently compare their model outputs with the weather that actually develops. This leads to better and more accurate models. The Commission should maintain a healthy interest in the alignment, or lack of alignment, between its cost models and the rates that customers actually pay for telephone service.

**4. THE COMMISSION SHOULD DEFINE RURAL RATES TO BE “REASONABLY COMPARABLE”
WHEN THEY ARE NOT MORE THAN 125 PERCENT OF AVERAGE URBAN RATES.**

The Commission sought comment on how it should determine whether rates (or costs) are reasonably comparable (“comparability standard”). Notice para. 16. In our view, the Commission should establish a system to ensure that rural rates are not more than 125 percent of a suitably defined average urban rate.

possibly even some “vertical services.” In addition, the Commission might want to normalize or adjusted the measured rates for common return and depreciation rates.

When Congress required the Commission to ensure that rates in rural and high cost areas are “reasonably comparable” to those in urban areas, it did not define the term, and it left the task to the Commission. While the Commission has some discretion to set the comparability standard, in our view the Act permits rate differences within a fairly narrow range.

One approach to defining urban is to adopt a more precise verbal formula. The Commission tried this approach in the *Ninth Order*, but the Appeals Court disapproved of this technique because it did not in the end “illuminate the dispute.”¹³ It seems that a numerical standard is required. A numerical standard would clearly allow the courts a meaningful opportunity to review whether support is sufficient.

The intent of Congress in enacting Section 254 may be illuminated by decisions of courts and administrative agencies that have interpreted the phrase “reasonably comparable” in other contexts. Generally, the courts have applied the term narrowly, although they have generally declined to offer a precise quantitative definition.

Analogous precedent is found in the context of natural gas regulation. Under Section 311 of the Natural Gas Policy Act, the Federal Energy Regulatory Commission (“FERC”) approves the transportation rates of intrastate natural gas pipelines only if they are “reasonably comparable” to the rates that would be allowed to an interstate pipeline. Over the years, the FERC has narrowly construed this standard. In one case, the FERC stated that an intrastate rate is “reasonably comparable” if it is within the range of interstate rates in the areas affected. An intrastate rate may be “somewhat higher than some of the comparison rates, as long as it is lower than others.”¹⁴ Of course, where interstate rates are closely grouped, this allows only a small

¹³ The FCC had previously defined reasonably comparable rates as comprising “a fair range of urban/rural rates both within a state's borders, and among states nationwide,” for example, *Qwest v. FCC*, 258 F.3d 1191, 1201 (10th Cir. 2001).

¹⁴ *Producer's Gas Company*, 35 FERC Record, 63,042, Released May 12, 1986.

variation for intrastate rates. In other cases under Section 311, the FERC has adopted an even narrower construction, essentially requiring rates that are similar to those that would be set by an interstate pipeline.¹⁵ One FERC commissioner even characterized the FERC policy as requiring “essentially equal” rates.¹⁶ Thus in a situation similar to the present one – where rates set by a federal agency must be “reasonably comparable” to a standard – the FERC has allowed only small deviations, if any at all, from the base for comparison purposes. Applying the FERC standard here, rural rates (net of support) would need to be within the range of urban costs, or have only a small deviation from such costs.

“Reasonably comparable” has also been construed by courts in some other contexts. These cases also suggest that the Commission must take a narrow view of the permissible differences between urban and rural rates. One case suggests that a synonym for “reasonably comparable” is “roughly equivalent.”¹⁷ In the context of property taxation, where the value of property is sometimes defined by the sale prices of “reasonably comparable” properties, the parameters are sometimes very narrow as to what may be considered a “reasonably comparable” property.¹⁸

While it is difficult to define an outer limit for the comparability standard, some differences clearly are outside that limit. For example, we think the Commission would certainly violate the Act with a comparability standard of 150 percent. It is implausible to suggest that a \$20 price is “comparable” in any sense to a \$30 price for the same service. Most consumers would not be indifferent to such a price difference. Indeed, if “comparability” has any meaning

¹⁵ *Mustang Fuel Corp.*, 31 FERC Record, 61,265, Released June 4, 1985.

¹⁶ See *Delphi Gas Pipeline Corp.*, 43 FERC Record Page 61,024, concurring statement of Commissioner Trabandt.

¹⁷ *Dartmouth Review v. Dartmouth College*, 889 F.2d 13,19 (1st Cir. 1989).

¹⁸ See, e.g., *Wisconsin v. City of Madison*, 178 Wis.2d 577 (1993).

at all, these two prices are more “non-comparable” than they are “comparable”; they are more different than they are alike.

The context is universal service and the task is to effectuate the intent of Congress in using the words “reasonably comparable.” Perhaps what is “comparable” should be seen through the eyes of the consumer. Thus one possibility is to define a numerical standard for “reasonably comparable” by using actual consumer judgments about material price differences. The concept is that two rates are not “comparable” if a suitably defined customer with a choice is not indifferent and considers the price difference materially different. In this way the decisions made by urban customers with a choice of providers can inform the scope of the benefits delivered by section 254 to rural customers who don’t have access to those urban rates. Of course, the Commission would still need in the end to adopt a numerical definition for reasonably comparable, but this behavioral stepping stone offers the Commission an opportunity to inform its policy with empirical research and to tie it to the reality of consumer behavior.

If this method is used, data collection must be carefully circumscribed. Data on consumer choice would be relevant only in a market where customers have a choice of providers and where effective competition exists.¹⁹ The Rural State Commissions note that such conditions do not presently exist in the local exchange markets within their states.

Using this method, rates for two telecommunications services of equal quality might be defined as “comparable” when the services are provided in an effectively competitive market, and when a price-conscious consumer who is actively shopping for a service and who has good

¹⁹ This generally requires at least five competitors dividing the market into equal shares. Shepherd, William G., *Anti-Competitive Impacts of Secret Strategic Pricing in the Electricity Industry*, Public Utilities Fortnightly, Vol. 135(4), February 15, 1997, pp. 24-29.

information about price would be largely indifferent. Conversely, if rates are not comparable, a price-conscious and actively shopping consumer will nearly always choose the lower rate.²⁰

The “reasonably comparable” standard is less exacting than the “comparable” standard, and it therefore tolerates a somewhat greater rate disparity. In the context of consumer behavior, this definitional difference could be translated into altered assumptions about the consumer. Rates for two services might be considered “reasonably comparable,” in this sense, if a less active and less informed consumer would be indifferent. That is, rates for two telecommunications services of equal quality might be defined as “reasonably comparable” when the services are provided in an effectively competitive market, and when an average consumer who is not actively shopping for a service and who has average information about price would be largely indifferent. Conversely, if rates are not reasonably comparable, an average consumer with average knowledge would quite likely choose the carrier offering the lower rate.

There is considerable experience in some parts of the country about how large a rate difference is needed to induce telephone customers to switch from one carrier to another. Published economic literature may also produce valuable information about how large a price difference is tolerated by telephone customers before they begin to switch to the lower cost carrier.

If “reasonably comparable” is defined by consumer behavior, experience in other effectively competitive markets can provide additional evidence. Gasoline prices offer an

²⁰ The Notice observes that costs in rural areas may be one hundred times greater than costs in urban areas. The Notice then suggests that the definition of reasonably comparable should “tak[e] into account such cost differences.” Notice, paragraph 16. Setting the issue in this context may unfairly prejudge the issue by suggesting that two rates may be “reasonably comparable” so long as the one is substantially less than one-hundred times as large as the other. This suggestion is totally inappropriate. For reasons explained more fully below relating to statewide averaging of costs, the Rural State Commissions assert that the range of cost differences produced by the Synthesis Cost Model among wire centers offers little or nothing as to when urban and rural rates are comparable.

analogy.²¹ The price variation at one time within a single locality in Maine or Vermont typically is less than 10%. Thus based on our observations of customer behavior, a 13 cent per gallon difference on a base of about \$1.30 would cause many customers to seek out the lower price, even if it means discarding one's accustomed merchant.²² Thus for gasoline (a simplified analogy for local exchange), two prices that differ by more than 10 percent are not reasonably comparable.

In telecommunications as with gasoline, rates may need to be within 10 percent of each other to be reasonably comparable. Any larger difference, it seems to us, would produce significant customer migration by customers with choice, even though they may not be actively shopping. Thus a rate difference larger than 10 percent would deprive rural customers who have no choice of the benefits the Act.

At the same time, we recognize that adoption of this standard would have profound effects on universal service. We also recognize that our conclusion is based only upon informal empirical research and general experience in the telecommunications field. For these reasons, the Rural State Commissions would accept a definition of reasonably comparable by which rural rates are not more than 125% of a suitably defined national urban average. This means that if the rate or cost of serving an urban customer is \$20.00, then no rural customer would have a rate cost (net of federal support) greater than \$25.00.

5. THE COMMISSION SHOULD NOT ESTABLISH A GOAL OF REDUCING FUND SIZE.

The Commission sought comment generally on whether, in determining when support is sufficient, it should give weight to other principles. In particular, the Notice mentioned that the

²¹ The analogy is necessarily simplified because gasoline is a less complex product than local exchange services.

²² Some customers would be much more price sensitive.

Commission previously balanced sufficiency against the “goal of ensuring that the fund is no larger than necessary to minimize the burdens on the carriers that contribute.” Notice para. 17.

The Commission should not give any weight to the goal of reducing the size of the fund. First, this goal is not listed in Section 254 of the Act. Further, if size were considered, it would effectively negate the “sufficiency” principle. Any arbitrarily determined level of support could be justified as a balance between the needs of those who receive the support and the burdens on those who provide it. Thus any level of support would arguably be sufficient, and a reviewing court would have no objective means to ascertain whether the Commission has complied with the statute. In this regard, it is noteworthy that sufficiency is not merely a “principle” in section 254(b)(5), but is also independently mentioned in section 254(e), which directs that support “should” be sufficient and section 254(d) which refers to the Commission’s “specific, predictable and sufficient” support mechanism.

We understand that high cost support for nonrural carriers is a hotly contested area, and one that generates considerable opposition. We note, however, that the current program is almost financially insignificant in relation to the whole federal universal service fund. Support for nonrural carriers in 2002 is estimated at \$232 million, only four percent of the total program disbursements.²³ Even if the Commission thought reducing fund size were an important goal because of the burden it places on carriers, it would be unreasonable to apply that criterion solely to a program that disburses only four percent of the funds.

²³ USAC reported a second quarter funding requirement of \$58.1 million for 2Q02, or an annual rate of \$232 million. This comprises only 4 percent of the total funding of \$1.38 billion for high cost, low income, rural health care, and schools and libraries. All these figures ignore administrative cost.

6. IF RATES ARE REASONABLY COMPARABLE THEN SUPPORT IS SUFFICIENT

The Notice asks whether the existence of reasonably comparable rates means that support is sufficient. Notice, para. 17. The Rural State Commissions assert that the answer is “yes.” If “reasonably comparable” rates exist, then support is sufficient to achieve the purpose of the support.

7. IN DETERMINING WHETHER FEDERAL SUPPORT IS SUFFICIENT, THE COMMISSION SHOULD ASSUME THAT STATES WILL ENSURE COMPARABLE RATES WITHIN THEIR OWN BORDERS AND SHOULD CONTINUE TO USE STATEWIDE AVERAGE COSTS.

The Commission sought comment generally on whether when federal support is “sufficient.” More particularly, the Commission also sought comment generally on whether when federal support alone is responsible to providing “sufficient” support or whether sufficiency should be determined by considering state and federal support together. Notice para. 17.

These questions require the Commission to allocate responsibility under the Act as between state and federal universal service programs. Before making such decisions, however, it is essential to understand the differences among the states and their inherent capabilities and limitations regarding universal service policy.

States differ significantly in the percentage of their customers that are rural and in the percentage of those rural customers served by small “rural telephone companies.” In some states, virtually all urban customers are served by a single large company, often a “Bell” company. In these states, rural areas are predominantly served by independent telephone

companies, cooperatives and municipal telephone companies.²⁴ In other states, a majority of rural customers are served by the same large “Bell” company that serves the urban areas.²⁵

Rate policy varies among states. At least one state has established the goal that rates will be nearly identical for all customers in the state.²⁶ More commonly, states have uniform rates for the customers of their large “Bell” carrier and varying rates for independent telephone companies.²⁷

Regardless of the uniformity of their actual rates, however, states have as many as three tools to achieve rate comparability within their borders:

- 1) Rate Averaging. This is a means of requiring greater contributions to common costs from some customers than from others. To the extent that it operates like “support” under section 254, it is implicit support.
- 2) Cost Pooling. Some states may have authority to create cost pools among carriers. Under this mechanism, customers of one carrier may make implicit contributions to support rate reductions for customers of other carriers. This mechanism is similar to the Common Line Pool operated by NECA.
- 3) Universal Service. States may use their authority under section 254(f) to raise funds for high cost areas.

All three methods generate some revenue from some ratepayers in the state for the benefit of other ratepayers in the state.

²⁴ This pattern is seen primarily west of the Mississippi River, and notably in Iowa which has more than 150 independent companies. Similarly, in Alaska, a high proportion of the state’s total customers are served by its single large company and outlying areas are served by independents.

²⁵ This second pattern is seen primarily east of the Mississippi River, notably in Maine, Mississippi, Vermont, and West Virginia.

²⁶ Maine has adopted such a program of uniform statewide rates, but still allows local rate differences based on calling area sizes. Maine Public Utility Commission Rules, Chapter 288, High Cost Universal Service Fund.

²⁷ Vermont has rates of this kind. Verizon-Vermont customers pay rates with only minor differences from one exchange to another. Rates paid by independent telephone customers vary by greater amounts, however.

Using one or a combination of these methods, any state can achieve equal rates within its borders. Regardless of the tool used, the effect is the same: all ratepayers pay the same rates within the state based upon the average costs within that state.

What a state program cannot do by itself, however, is reduce its average rates or average cost. None of the above methods changes the state average cost, and none change the total amount of money that the state's ratepayers must generate. For this reason, a state universal service program cannot reduce high average costs. Only the Commission can address this problem, where it exists.

For these reasons, we recommend that the Commission establish a clear division of labor between its own programs and those of the states. States should be primarily responsible for rate and cost differences within their own borders. The Commission should complement this activity by assuming primary responsibility to make rates lower in those states that cannot, through their own efforts, otherwise achieve the reasonably comparable rates standard. Accordingly, the Rural State Commissions assert that the Commission should:

- 1) Presume that each state has an efficient mechanism to equalize rates within the state.
- 2) Continue to base federal support on statewide average costs or rates.²⁸
- 3) Consider federal support sufficient when it provides enough support so that no customer must pay a rate greater than an amount reasonably comparable to rates in urban areas of the nation. Thus the Commission should continue to focus its supports on states that, because they have

²⁸ The Commission should probably also allow individual states to burst this presumption based on unusual circumstances and thus benefit from a less rigorous estimate of the effectiveness of the state programs.

high average costs and rates, cannot achieve reasonably comparable rates through their own efforts.

Our recommendation is consistent with existing Commission policy for nonrural carriers. Through the use of statewide averaging, the Commission today correctly perceives its half of the dual federal and state role in supporting universal service. This is based upon the perception that it is the states that:

have the primary responsibility for ensuring reasonable comparability of rates within their borders. The federal mechanism leaves this state role intact, but provides support to carriers in states with average costs substantially in excess of the national average.²⁹

This leaves the federal role to that of shifting money from relatively low cost states to high cost states, to ensure reasonable comparability of rates *among* the states, not *within* states. The Commission further explained its reason for statewide averaging as follows:

Federal universal service high-cost support should be sufficient to enable reasonably comparable rates among states, while leaving states with sufficient resources to set rates for intrastate services that are reasonably comparable to rates charged for similar services within their borders.³⁰

Our recommendation is consistent with these earlier policy statements, which were upheld by the Tenth Circuit.³¹ Also, our recommendation tends to minimize the need for additional support, because the Commission has no need to supplant with universal service support the subsidies and contributions that are now raised through state policies.

²⁹ *Ninth Report and Order*, para. 46.

³⁰ *Ninth Report and Order*, para. 7.

³¹ Qwest challenged all three aspects of the Commission's methodology in the Appeals Court: (1) the decision to use nationwide average cost rather than an average urban cost as a basis of ensuring reasonably comparable rural and urban rates; (2) the decision to adopt a trigger or a benchmark for support at 135% of the national average cost per line; and (3) the decision to measure or average nonrural telephone companies' costs of providing universal service on a statewide basis ("statewide averaging"). Although the Court remanded on the first two points, the statewide averaging issue claim that was rejected was based on the "explicit" language in 254(e).

8. THE COMMISSION SHOULD EXPLAIN THE RELATIONSHIP OF ANY BENCHMARK IT SELECTS TO URBAN COST.

The Commission sought comment on how, if it continues to use nationwide average costs and average statewide costs, it can measure reasonable comparability when rural costs are included in the nationwide average. Notice para. 21. Should the Commission decide to keep a benchmark based upon nationwide average cost, the Rural State Commissions submit that the Commission should nevertheless select that benchmark as the result of an explicit calculation that relates the chosen benchmark to urban average cost. An example of such a calculation is shown in the following section.

We suggest, however, that the benchmark could be stated in a more useful manner. Rather than expressing it as a multiple of national average cost, the commission could state it directly as a multiple of urban cost. Because the benchmark remains in fact a dollar amount, this alternate method produces the same mathematical result. However, our alternative more clearly responds to the principles expressed in section 254(b)(3).

9. THE COMMISSION SHOULD ADOPT A NEW BENCHMARK NOT HIGHER THAN 125% OF URBAN COST.

The Commission sought comment on whether it should abandon the existing 135% benchmark and adopt a new benchmark. Notice para. 20. The Rural State Commissions assert that the Commission should abandon the current benchmark of 135% of national cost and adopt a new benchmark (possibly in conjunction with other changes) that will achieve reasonably comparable rates. If that benchmark is still to be based upon national average cost, our preliminary estimate is that the benchmark should be not higher than 106 percent.

The following analysis assumes that in this remand proceeding, the Commission is primarily interested in making relatively narrow adjustments to the existing cost model, and is not interested in broader questions such as whether it should abandon its forward-looking Synthesis Cost Model or base support on rates rather than costs. Therefore the following comments assume that the Commission will continue to use its cost model and its existing support calculation method, and that there will not be significant separations changes. The comments thus answer the narrow question of what should replace the 135% parameter.

The fundamental task is to produce enough support so that the rates in all states satisfy comparability test. The definition of “urban” therefore bears strongly on this question. As noted above, we suggest a fairly detailed density-based analysis to define urban wire centers. Such an analysis is beyond our present capabilities, however, but we have made some calculations under the simpler wire center size method.

Our working definition in this case is that wire centers with more than 20,000 lines are “urban.” There are 2,676 such wire centers meeting this criterion, amounting to 24 percent of the 11,119 wire centers in the nonrural carrier data set. Two averages are relevant. The average cost for all wire centers (the entire data set) is \$21.92. The average weighted cost for the urban subset is \$18.56. We note this is probably a conservatively high estimate of urban cost, in part because our wire center subset probably includes some suburban wire centers.³² Another reason to think that \$18.56 is a conservatively high estimate is the cost of the District of Columbia. D.C. is the only fully urban jurisdiction among all nonrural carriers, and its average cost is considerably lower, \$16.03.

³² This conclusion is strengthened by the fact that the average cost for a smaller subset of wire centers, having 50,000 lines or more, is \$17.48, more than a dollar lower.

We asserted above that rural rates and costs are reasonably comparable if they are not more than 125% of average urban costs. Thus the maximum net cost allowable after support would be:

$$\$18.56 \times 125\% = \$23.20.$$

By setting a benchmark of \$23.20, the Commission would be ensuring that no rural customer should have a higher net cost after support than \$23.20.

There are many ways to express a benchmark of \$23.20. The Commission might elect, as it has in the past, to state the benchmark as a multiple of the national average cost. In that case, the benchmark would be equal to:

$$\$23.20 / \$21.92 = 106 \text{ percent.}$$

In other words, if the Commission defines the benchmark as a multiple of national average cost, it should select a benchmark no higher than 106%.³³ We emphasize that this is a conservative estimate, in part because we based it upon our conservative estimate that rates can be reasonably comparable even though they differ by 25% and in part because we have used a conservatively high estimate for average urban cost.

10. THE COMMISSION SHOULD NOT ADOPT A STEP FUNCTION BENCHMARK

The Commission sought comment on whether it should adopt a “step function” benchmark. Notice para. 20. The Rural State Commissions assert that the Commission should not do so.

³³ All else equal, this benchmark would require support for nonrural carriers, exclusive of hold-harmless support, of \$1.276 billion. This is approximately 5.5 times the current annual funding level of \$0.232 billion. The amount of support thus required would be reasonably comparable to that currently provided to “rural telephone companies” who receive loop and switching support for intrastate costs and who serve a minority of rural customers nationwide.

The Commission must provide sufficient support to make rates in all states reasonably comparable to urban rates. For states with high average costs, it must provide support adequate to reduce net rates in a way that meets the comparability requirement. The commission might also elect to provide additional support by adopting a step function. Such a step function presumably would provide assistance to other states or carriers that do not need that support in order to meet the comparability requirement. This might broaden the base of popular support for the high cost program, since additional money could be thinly spread to some of the 43 states (and Puerto Rico) currently deprived of support for their nonrural carriers. Thus a program with a step function would operate more like the schools and libraries program, which has substantial public support, and which provides at least some financial support to most schools.

11. IF THE COMMISSION ESTABLISHES A CONDITION OF FEDERAL SUPPORT, IT SHOULD REQUIRE NO MORE THAN THAT STATES CERTIFY COMPLIANCE WITH THE COMPARABILITY REQUIREMENTS OF SECTION 254.

The Commission sought comment on how it should create inducements for state action. In particular, the Commission asked whether it should implement a state share requirement, condition federal support on some form of state action, or enter into binding cooperative agreements. Notice para. 24.

We commented above that the Commission should retain the statewide averaging feature for measuring costs. We explained that this choice was based upon our recognition that federal and state support each have areas of strength. State programs are uniquely able to maintain equitable rates within a state's boundaries, while federal support is essential to equalize gross economic differences among the states. We noted that this suggests a specialization of function

for state and federal support programs. Accordingly, the Rural State Commissions feel that little if anything is needed in the way of inducements or conditions for state programs.

We do not comment regarding conditions for receiving support. We believe that if the Commission does adopt conditions, those conditions should be minimally intrusive of state ratemaking policies. If a condition is adopted, however, it should require no more than that the rates for carriers in their state comply with the comparability requirements of Section 254 of the Act. Cooperative agreements are not necessary because states have independent responsibility to keep rates within their borders reasonably comparable, not to mention strong state-based reasons to reach the same result.

The proposal for a state share requirement was rejected by the Commission in its *Ninth Order* and should also be rejected here. The original purpose of the state share proposal was to ensure that no federal funds are distributed to a state that has not taken reasonable steps to finance its own needs. The Commission correctly realized, however, that the averaging of costs statewide achieves this purpose. States with some high cost carriers and some low cost carriers now cannot receive federal support unless their overall cost is high. Moreover, the existing system avoids the possibility of a harsh result. Under a state share system, a state with very high cost would be required to generate some support within the state, even if its rates were uniform statewide. Such a condition would inappropriately add to the already high rates in that state. Thus statewide cost averaging is actually a better mechanism than the Joint Board's original state share proposal.

Respectfully submitted,

s/ Joel Shifman

Joel Shifman, Esq. for
Maine Public Utilities Commission
24 State Street
18 State House Station
Augusta, ME 04333

s/ Martin Jacobson

Martin Jacobson, Esq., for
Montana Public Service Commission
1701 Prospect Avenue
PO Box 202601
Helena, Montana 59620-2601

s/ Peter Bluhm

Peter Bluhm, Esq., for
Vermont Public Service Board
112 State Street, Drawer 20
Montpelier, Vermont 05620-2701